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Bringing it all together: Conclusions

Paul Johnson, IFS and Frontier Economics

Assessing tax policy

- Baseline is a progressive neutral system which:
- Works as a system
- Doesn't discriminate between similar activities
  - Except under very limited conditions
  - Balances economic and practical considerations
- Achieves progressivity as efficiently as possible

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  - Failure to price congestion properly
- Does not achieve progressivity efficiently
  - VAT zero rating a poor way to redistribute
  - Taxes and benefits damage work incentives more than necessary

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  - Imposing a consistent tax on GHG emissions and on congestion
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- Achieve progressivity through the direct tax and benefit system
  - Recognising constraints imposed by responses to incentives
  - Taking account of lifetime welfare

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Earnings taxes should be progressive, coherent and reflective of behavioural responses

- Merge income tax and NICs
- End the tapering of personal allowances and move to a transparent and coherent rate schedule
- Introduce a single integrated benefit
  - Ensuring benefits fit together
  - Reducing administrative burden and complexity
  - Reducing the marginal rates faced by some low earners
- Focus on strengthening work incentives for:
  - Those aged 55 to 70
  - Those with school age children

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Indirect taxes should be applied much more uniformly

- Remove nearly all zero and reduced rates of VAT
  - with a compensation package that addresses work incentives as well as distributional concerns
- Introduce a tax equivalent to VAT on financial services
- Replace council tax and stamp duty on property with a single tax proportional to property value
  - and based on current price

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Environmental taxes should be focussed on the underlying externality

- There should be a consistent price on carbon emissions
  - through an extended EU ETS and a tax on other emissions
- Congestion charging needs eventually to replace most of current fuel duty

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The normal return to saving should not be taxed

full labour income tax rate should be applied to above normal returns

- Returns on ordinary interest bearing accounts should be excluded from tax altogether
- Current basis of pension taxation should be maintained
  - But employer contributions should not be so heavily subsidised
  - And the tax free lump sum should be reformed
- A rate of return allowance should be available for substantial holdings of risky assets
  - Whilst maintaining equity ISAs
- Tax rates on income and capital gains should be equalised
- We would like these reforms to be accompanied by a more effective tax on wealth transfers

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Business taxes should lead to neutrality between sources of finance and income

- An Allowance for Corporate Equity would align treatment of equity and debt finance
- Treatment of employment, self employment and corporate source income should be aligned
- Business rates should (if possible) be replaced by a land value tax

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These are radical changes

- A strategy for the long term
  - Not intended for the next budget or the one after that
  - Though a clear sense of direction needs to be set out
- Involving a lot of winners and losers
  - Inevitable with structural reforms, especially where the current system favours certain groups
  - Important to look over the lifecycle
- And much work to be done
  - Corporate and savings changes need extensive consultation
  - Can’t be certain exactly how a land value tax, VAT on financial services and a wealth transfer tax would work

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Conclusions

- The design of tax matters hugely for national prosperity
  - Not surprising when tax takes nearly 40% of GDP
- Reform is hard but the prize is big
- There has been little sense of direction on tax policy
  - Which is not good politics either
- The review sets out a possible direction
  - and challenges government to define a strategy
- We should "have a tax system which looks like someone designed it on purpose" former US Treasury Secretary William E. Simon

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